Optional: Introduction to budgeting terms

Now that you have learned how to create a project budget, let's discuss some of the common terms you will use when you are estimating, tracking, and maintaining it.

Cash flow

Cash flow is the inflow and outflow of cash on your project. As a project manager, this is important to understand because you need **funding** (cash into your project) to keep your project running.

Cash that comes into your project allows you to maintain and compensate resources and pay invoices for materials or outside services. In some cases, a project may start out with all of the cash it will receive until the end. If this is the case, it is important to monitor your outflow to ensure that you have enough funding to complete the project.

Monitoring cash flow allows you to have a reference point for your project's health. For example, if the cash flow coming into your project is lower than your outflow, you will need to adjust your budget. Planning and tracking the cash flow for your project is a key component of budget management.

CAPEX and OPEX

Organizations have a number of different types of expenses, from the wages they pay their employees to the cost of materials for their products. These expenses can be organized into different categories. Two of the most common are **CAPEX (capital expenses)** and **OPEX (operating expenses)**.

- CAPEX (capital expenses) are an organization's major, long-term, upfront expenses, such as buildings, equipment, and vehicles. They are generally for assets that the company will own and keep. The company incurs these expenses because they believe they will create a benefit for the company in the future.
- OPEX (operating expenses) are the short-term expenses that are required for the day-to-day tasks involved in running the company, such as wages, rent, and utilities. They are often recurring.

You may need to account for both OPEX and CAPEX on your projects. For example, a major software acquisition as part of an IT project could be treated by your organization as a capital expense. The monthly wages paid to a contractor to help deploy the software would be an operating expense. It's a good idea to talk to your finance or accounting department when you start working on your project budget to see how they determine the difference between OPEX and CAPEX. This will guide you in properly allocating capital and operating expenses for your projects.

Contingency reserves

Sometimes, a project hits a snag and incurs additional expenses. One way to prepare for unplanned costs is by using **contingency reserves**. Contingency reserves are funds added to the estimated project cost to cover identified risks. These are also referred to as **buffers**.

To determine the amount of your contingency reserves, you will need to go through the risk management process and identify the risks that are most likely to occur. We will go into more detail on risk management later in the course, but it is important to understand that risks to your project can have an impact on your budget.

Contingency reserves can also be used to cover areas where actual costs turn out to be higher than estimated costs. For example, you may estimate a certain amount for labor costs, but if a contracted worker on your team gets a raise, then the actual costs will be higher than you estimated.

Management reserves

While contingency reserves are used to cover the costs of identified risks, **management reserves** are used to cover the costs of unidentified risks. For example, if you were managing a construction project and a meteor hit your machinery, you could use management reserves to cover the costs of the damage.

Contingency reserves are an estimated amount, whereas management reserves are generally a percentage of the total cost of the project. To determine a project's management reserves, you can estimate a percentage of the budget to set aside. This estimate is typically between 5–10%, but the amount is based on the complexity of the project. A project with a more complex scope may require higher management reserves. Note that the project manager will generally need approval from the project sponsor in order to use management reserves.

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